The Financial Reporting of Pensions

A response by

CFA Society of the UK

About CFA Society of the UK

The CFA Society of the UK (CFA UK), formerly UKSIP, represents the interests of over 7,000 leading members of the investment industry. The society, which was founded in 1955, is one of the largest member societies of the CFA Institute and is committed to leading the development of the investment industry through the promotion of the highest ethical standards and through the provision of education, professional development, advocacy, information and career support on behalf of its members. CFA UK supports the CFA, ASIP, a recognized qualification of CFA Institute, and IMC designations. Most members hold either the Chartered Financial Analyst (CFA), or Associate of the Society of Investment Professionals (ASIP) designation. The ASIP designation is held by those who successfully completed the Associate examinations. CFA Institute is best known for developing and administering the CFA curriculum and examinations and issuing the CFA charter. CFA Institute's mission is to lead the investment profession globally by setting the highest standards of ethics, education and professional excellence.

Most CFA UK members also belong to the CFA Institute and reaffirm annually their adherence to its Standards of Professional conduct. Both CFA UK and CFA Institute are committed to providing members with a wide range of professional development opportunities. All members are encouraged to undertake ongoing post-qualification professional development.

CFA UK is the awarding body for the IMC, the benchmark entry-level qualification for those working in investment management in the UK. The examination is accredited by the Qualifications and Curriculum Authority (QCA) and is designated an 'appropriate examination' by the Financial Services Skills Council (FSSC) for the purposes of the Financial Services Authority's training and competence requirements. The IMC is held by over 15,000 investment professionals.

About this response

The society welcomes the opportunity to respond to the ASB's consultation paper on The Financial Reporting of Pensions. When preparing our response we also surveyed our members and received more than 100 individual responses. Please see attached copy of the survey results.
The results were: 65% voted against the proposal that expected future salary increases should be excluded from the calculation of liabilities. 53% supported the use of the risk-free rate to calculate pension liabilities.

This indicates an overall conservative view: they do not want to lose sight of the expected impact of future salary increases on a company's pension obligations; and they prefer (by a small majority) the risk-free rate, which would result in a more conservative view of the liabilities than the present discount rate.

A minority of respondents supplied comments which are also included in the survey results attached.

Response to questions

Q1 Should a liability to pay benefits that is recognised be based on expectations of employees' pensionable salaries when they leave service, or on current salaries (including non-discretionary increases)?

It has been proved over a long time that there will be salary increases, and so the calculation that includes the expectation that this will continue provides useful information. It would be a shame to lose this. A majority (65:35) of respondents to the CFA UK survey voted against this proposed change. The Accounting Advocacy Committee also felt that this information should not be lost but some members recognise that there are strong arguments for only putting in existing salaries. Disclosure of the gap between present obligations only and a figure including future salary increases might encourage the sponsor to manage (down) the liabilities, which would benefit investors.

Q2 Should financial reporting be based on the premise that a liability is owed to an individual employee or to the workforce as a whole? What consequences do you consider your view has for the recognition and measurement of pension obligations?

No comment

Q3 Do you agree that recognition should be based on the principle of reflecting only present obligations as liabilities?

See above. Although it can be argued that this is the correct interpretation of the principle, in practice salaries do increase. Pensions accounting includes predictions about the future eg the expected mortality rate. Our survey results and committee discussion suggest that CFA UK members prefer to see calculations of liabilities that include all known risks (of which salary increases is one in this case), including the "worst case" scenario.

Q4 Do you agree that the consolidation of pension plans should be subject to the same principles as are usually applied in determining whether consolidation is appropriate?

Agreed.

Q5 Do you agree that changes in assets and liabilities relating to pension plans should be recognised immediately, rather than deferred and recognised over a number of accounting periods or left unrecognised provided they are within certain limits (a 'corridor') approach?

Agreed. CFA UK does not support the corridor approach.

Q6 Do you agree with the paper's views in the measurement of liabilities to pay benefits? In particular, do you agree that:

Q6a Regulatory measures should not replace measures derived from general accounting principles?

Agreed.

Q6b The discount rate should reflect the time value of money only, and therefore should be a risk-free rate?

In the survey, a small majority (53:47) of our members supported the use of a risk-free rate. In the advocacy committee discussion, views also tended in this direction: use of a higher discount rate may portray an overly rosy view of the pension fund's liabilities and a risk-free rate is a more accurate reflection of their characteristics. However, there was concern about the market impact of attempts to match these liabilities by buying government bonds because of insufficient supply. This means the market rate might be distorted by additional demand for a limited pool of assets. This may not be the concern of standard-setters but the doubts about the need for change suggest that the ASB needs to make a more convincing case.

Q6c Information about the riskiness of a liability (i.e. the risk that the amount of pension benefits will differ from today's expectations) is best conveyed by disclosure rather than by adjusting the amount of the reported liability?

No comment.

Q6d The liability should not be reduced to reflect its credit risk?

Agreed.

Q6e Expenses of administering the plan's accrued benefits should be reflected in the liability?

No comment.

Q7 Where employees have options to receive benefits in different ways, should the liability be reported at the highest amount or at an amount that reflects the probability of different outcomes?

No hard conclusion. A suggestion is that the reported liability should reflect the probability of different outcomes to be accompanied by disclosure of worst possible outcome.

Q8 Do you agree that assets held to pay benefits should be reported at current values?

Agreed.

Q9 Do you agree that a 'net' asset or liability should be based on the difference between the amounts at which the assets and liabilities would be measured if they were measured directly?

Agreed.

Q10 Do you agree that the different components of changes in liabilities and/or assets should be presented separately?

Agreed.

Q11 Do you agree that the financial performance of an entity should reflect the actual return on assets, rather than the expected return, and that the expected return should be required to be disclosed?

Agreed.

Q12 Do you agree with the objectives of disclosure that are identified in this Chapter? Are there specific disclosure requirements that should be added to or deleted from those proposed?

Agreed.

Q13 Do you agree that multi-employer plans should be reflected in an employer's financial statements using the same principles as those that apply to a single employer plan? How, in your view, should an accounting standard require that this be implemented in practice?

Multi-employer plans should be reflected proportionally in an employer's financial statements. The same principles as for a single employer plan should be employed.

Q14 Do you agree that a pension plan's general purpose financial report should include its liabilities to pay benefits in the future? Do you agree that the plan's liabilities for future benefits should be quantified using the same principles as an employer's liability?

Agreed. Such an arrangement might help to focus the minds of pension fund trustees and beneficiaries on the fund's true financial position.

Q15 Do you agree that a pension plan's statement of financial position should reflect an asset in respect of amounts potentially receivable under an employer's covenant, and that this should reflect the employer's credit risk?

Agreed. Such an arrangement might help to focus the minds of pension fund trustees and beneficiaries on the fund's reliance on the employer's covenant.

Q16 Are there types of pension arrangements that require further consideration? Please identify the specific features of these arrangements and suggest how the principles of this paper would require development to secure appropriate financial reporting for them.

No comment.

Q17 Are there further specific issues relating to the cost and benefit of the proposals that should be taken account of in their further development?

See response to question 6 on the risk free discount rate. As a matter of principle, there should always be a cost benefit analysis relating to proposed changes.

July 2008